United States Court of Appeals

for the Second Circuit

APPELLANT'S REPLY BRIEF

ORIGINAL

To be argued by
JOSEPH J. SANTORA

76-7050

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United States Court of Appeals
FOR THE SECOND CIRCUIT

MARX & CO., INC., JOHN V. SUMMERLIN, JR., OTTO MARX, JR., WILLIAM D. FUGAZY and LOUIS V. FUGAZY,
Plaintiffs-Cross-Appellants,

P/S

against

THE DINERS' CLUB, INC., DINERS/FUGAZY TRAVEL, INC., THE CONTINENTAL CORPORATION and THE CONTINENTAL INSURANCE COMPANY,
Defendants-Cross-Appellees,

THE DINERS' CLUB, INC., DINERS/FUGAZY TRAVEL, INC.,
Defendants-Appellants,

against

WILLIAM D. FUGAZY, LOUIS V. FUGAZY, JOHN V. SUMMERLIN, JR., OTTO MARX, JR., MARX & CO., INC. and F.T. VENTURES, INC.,
Plaintiffs-Appellees.

ON APPEAL FROM AN ORDER AND JUDGMENT OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK

REPLY BRIEF FOR DEFENDANTS-APPELLANTS AND ANSWERING BRIEF FOR CROSS-APPELLEES

HARDEE BAROVICK KONECKY & BRAUN
One Dag Hammarskjold Plaza
New York, New York 10017
Attorneys for Defendants-Appellants and Cross-Appellees

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REPLY BRIEF FOR DEFENDANTS-APPELLANTS AND ANSWERING BRIEF FOR CROSS-APPELLEES

Defendants-Appellants' Reply Brief

Introductory Statement

The Diners brief clearly demonstrated that the complete non-performance by the Fugazys of the conditions precedent has never been a contested fact (D. Br. 9-12, 14-15, 41-48)* and that the merits of the accord defense

* The letters "D. Br." and "F. Br." followed by numerals are used to denote references to the main briefs submitted by Diners and the Fugazys, respectively.

constitute a complete bar to the Fugazy contract claim (D. Br. 15-17, 35-41). The Fugazys' brief does not challenge and thereby concedes these facts. However, in an attempt to avoid and obscure the merits of the legal issues in this case and the errors surrounding the rebuttal testimony of their expert, the Fugazys have chosen to present inapposite citations to the record, material misstatements of Diners' contentions and a series of confusing and inapplicable arguments. It is respectfully submitted that the arguments contained in the Fugazys' brief are unsupported by their own citations, and are refuted by the record and applicable legal authorities. It is further submitted that the Fugazys' brief is more significant in what it omits than what it includes. In failing to deal with the merits of the legal issues raised on this appeal, the Fugazys' brief confirms that Diners is entitled to the relief it seeks on this appeal with respect to the 1969 claim and the counterclaims.

ARGUMENT

POINT I

The Fugazys failed to excuse their non-performance of the conditions precedent and the Court below should have granted Diners' motion dismissing the 1969 claim.

There has never been any dispute that the Fugazys failed to perform the conditions precedent (D. Br. 14-15; F. Br. 6, 12-14, 27), and it is conceded that proof of performance of all conditions is an indispensable element of a cause of action for breach of contract. (D. 145, p. A-409) Since non-performance of the conditions was admitted in this case, the Fugazys could not make out even a *prima facie* case in contract without establishing a legally sufficient excuse for non-performance. However, they never mentioned excusable non-performance throughout the trial and, of course, offered no evidence in support thereof. They never raised the issue on Diners' motions for a directed verdict when Diners invoked the non-per-

formance of the conditions as a complete defense and never asked the Court to instruct the jury on excusable non-performance. That issue was never identified at the trial in any way and was not presented to the jury.

The issue of excusable non-performance surfaced for the first time four months after the verdict was rendered. In denying Diners' post-trial motion, the Court suggested, *sua sponte,* that the Fugazys' non-performance of the conditions might have been disregarded by the jury on the basis that the jury could have concluded that Diners prevented or hindered the performance. (D. 145, pp. A-409-410; D. Br. 41-43) Excusable non-performance is a legal doctrine and was never even identified, and certainly never explicated at trial or presented to the jury. The jurors could not have considered it in reaching their verdict unless they were educated as to the facts, arguments and applicable law from a source other than the trial. Since the issue was never litigated or even identified at trial, the jury cannot be deemed to have considered it, and the Fugazys are precluded from raising it *de novo* on this appeal, to support the verdict.

Furthermore, there can be no finding on this record that the Fugazys' non-performance was caused by acts of prevention or hindrance on the part of Diners and was thereby excused. Certainly, that argument could not be applicable to the Indemnity Condition. The Fugazys do not even suggest that Diners committed any act which prevented or hindered them from tendering an indemnity, and do not even bother to offer any reason for their failure to perform. They merely state that Diners did not "raise the question" until August 1969, which is a legally insufficient basis to excuse their non-performance. (D. Br. 43-44, 45-46) Thus, even if this Court permits the Fugazys to argue prevention or hindrance on this appeal, that argument is totally inapplicable to the non-performance of the Indemnity Condition which remains a complete bar to the 1969 claim.

The Fugazys' belated attempt to apply the doctrine of excusable non-performance to the Payment Condition is

also futile, since it provides no basis for excusing the Fugazys' non-performance. The Fugazys offer no act of Diners which prevented or hindered them from tendering a sum of money and do not even bother to give any reason for their failure to tender any money. The Fugazys contend chiefly that Diners failed to demand payment or that Diners did "nothing". That contention is legally insufficient and actually precludes the invocation of the doctrine in this case. (D. 145, pp. A-409-A-410; D. Br. 43-44, 45-46) The Fugazys' suggestion that the jury could have inferred Diners furnished "excessive" cost estimates is ludicrous since the Fugazys did not make that contention at trial and the issue was never presented to the jury. The relatively slight difference in the estimates at different stages of the registration process (Ex. PPP, p. A-879; Ex. P, p. A-818) could not in and of itself even suggest that the estimates were "excessive". The earlier, concededly internal estimate (Ex. 55, p. A-799) was never even communicated to the Fugazys. The Fugazys cannot even suggest how the July and August cost estimates "prevented" or "hindered" them from tendering any money before July 15. Thus, the doctrine of prevention or hindrance cannot be invoked to excuse the Fugazys' non-performance of the Payment Condition which remains as a complete bar to the 1969 claim.

The Fugazys never performed the conditions as they were expressly required in the Contract and their non-performance was not compromised until agreement between the parties was reached on August 27, 1969. (D. Br. 14-17) Diners, therefore, had no obligation under the Contract to file a Registration Statement prior to August 27. (D. 145, p. A-409; D. Br. 9-12, 14-17) The filing on August 28, 1969 must be deemed "prompt" as a matter of law. The Court's refusal to grant Diners' directed verdict motion and its submission to the jury of the question of whether Diners was required by the Contract to file by June 20 or any date prior to August 28 (p. A-1599) was clearly erroneous as a matter of law. The jury's verdict, which is predicated on the finding that Diners was required to file by June 20 and to cause the

Registration Statement to become effective by August 29 (F. Br. 7-8; D. Br. 6, 21-23; D. 145, p. A-413), necessarily involved erroneous determinations of questions of law and must be reversed.

Immediately following the verdict, the Court, on Diners' oral motion, implicitly recognized the impropriety of the jury's verdict on the "prompt filing" claim but refused to overturn the verdict because the "best efforts" claim remained (pp. A-1665-A-1668). Since the Court subsequently determined that the verdict necessarily was premised on a finding that filing should have occurred on June 20, and effectiveness should have occurred approximately 70 days later on August 29 (D. 157, p. A-461), any impropriety with respect to the "prompt filing" clearly should have resulted in at least a new trial, whether or not the "best efforts" claim remained.

Furthermore, since August 28 is the earliest date that Diners could have been required to file as a matter of law, proper application by the Court of the law to the "best efforts" claim would have required the conclusion that Diners could not have been *required* to have the Registration Statement effective any earlier than December 1969; this conclusion would preclude damages in this case (D. Br. 17-18, 23-24, 67-69; F. Br., footnote, pp. 23-24).

The Fugazys argue that the jury was properly permitted to disregard the non-performance of the conditions because it could have inferred that Diners did "nothing" to effect registration until "late July" (F. Br. 11; D. 145, p. A-407). They miss the point that it was an error of law for the issue to be submitted to the jury when a complete legal defense, based upon undisputed fact, had been established by Diners and had not been overcome in any way by the Fugazys.

Even if the Fugazys had attempted during trial to contend and prove excusable non-performance of the conditions, and if they had sought a charge to that effect, their comment that Diners did "nothing" would have failed. The Fugazys admitted that Diners began work on

the registration in April 1969 (p. A-1112) and the record indicates substantial work and expenditure by Diners from April through July (D. Br. 11-14; pp. A-1488-A-1489).

The Fugazys' references to their offer to perform are without consequence since an offer cannot be a substitute for performance. *Witherell* v. *Lasky,* 286 App. Div. 533 (4th Dept. 1955). The Fugazys also suggest that Diners had "an affirmative duty of fair dealing and good faith cooperation" to perform unspecified acts (F. Br. 29-30). Then they imply that Diners breached that unspecified "duty" by doing nothing. No facts or authorities are offered which support that theory. The only case cited, *Rochester Park, Inc.* v. *City of Rochester* (F. Br. 29-30), is completely inapposite since the Court there found that the contract contained no condition precedent (D. Br. 43-46). The Fugazys' contention would also require the Court to revise the law of contracts in New York and to impose "implied conditions" which could improperly convert the conditions in the Contract into "mere promises". *Witherell* v. *Lasky, supra.* The Fugazys' theory does not excuse their non-performance and, since it has never been raised prior to this appeal, should not even be considered herein. Their non-performance stands as a complete bar to the 1969 claim.

POINT II

The accord compromising the Fugazys' failure to perform the conditions precedent requires the dismissal of the 1969 claim.

The refusal of the Court below to apply the accord solely on the basis that it had not been pleaded in Diners' answers prior to trial (D. 145, p. A-411, footnote 3 p. A-418), was clearly erroneous. (D. Br. 35-37) The Fugazys do not even attempt to support that portion of the Court's decision. Instead, they argue that the accord issue was never tried below and is, therefore, not available to Diners on this appeal. They argue that Diners

merely introduced Ex. WWW without any testimony and that that was insufficient to raise the issue in accordance with Rule 15(b). On the contrary, Diners introduced substantial evidence establishing the Fugazys' non-performance of the conditions, the dispute between the parties arising therefrom, and the acknowledgment by the Fugazys of the non-performance which was part of the agreement between the parties of August 27 that compromised the Fugazys' unfulfilled obligations. (D. Br. 9-17) The Fugazys discuss this evidence in their brief (F. Br. 27-28) and inadvertently acknowledge that they recognized these issues during the trial, when they argue that their expert was called to rebut such evidence. (F. Br. 36-37) Diners' counsel argued the point on the directed verdict motion (pp. A-1598-1599), in the closing statement (p. A-1612) and on the motion immediately following the verdict (pp. A-1666-A-1668) without objection by the Fugazys. The Fugazys cannot seriously deny they had full knowledge that Diners was contending that the agreement between the parties on August 27 was a bar to the 1969 claim both because it evidenced the Fugazys' admission of non-performance of a condition precedent and compromised a dispute.

The Fugazys' contention is apparently based solely on the fact that the word "compromise" rather than the word "accord" was used in the motion argument on May 23. The argument was held only moments after Friedman had, for the first time, articulated the "prompt filing" aspect of the 1969 claim on rebuttal, over Diners' objection. (p. A-1600) Any lack of precision in terms during the argument was occasioned only by the improper gamesmanship surrounding Friedman's testimony (See Points III, IV and V, *infra*).

In light of the ample evidence received, without objection, on the accord issue and the reference to the "compromise", the Fugazys had complete knowledge of the defense they now claim was never tried. Indeed, the Fugazys' failure to object to the evidence, including Ex.

WWW (p.A-889) and Ex. IIII (p. A-894), the documents specifically establishing the compromise of their obligation to perform the Payment Condition and the Imdemnity Condition, constituted a receipt of such evidence for all purposes and required the Court to consider the issue arising therefrom. *Bradford Audio Corporation* v. *Pious,* 392 F.2d 67, 73, 74 (2d Cir. 1968). Under the circumstances, the Court was required by Rule 15(b) to apply the accord issue on its merits and deem the pleadings to be amended accordingly. *SEC* v. *Rapp,* 304 F.2d 786 (2d Cir. 1962).

The cases cited by the Fugazys (F. Br., 32-35) involved situations where trial courts, in their discretion, refused to permit a formal amendment of pleadings during trial, in the face of an objection of surprise by the opposing party. Where, however, issues are tried by the express or implied consent of both parties, as here, the trial court has no discretion, but must deem the pleadings to be amended. *SEC* v. *Rapp, supra.* In the instant case, Diners articulated the defense of accord at the first opportunity after the Fugazys for the first time at the trial, through their expert Mr. Friedman, had articulated the claim to which accord was a defense—the prompt filing claim.

The Fugazys half-heartedly question whether Ex. WWW is an accord (F. Br., 28), but offer no facts or authorities on that point. They have actually conceded all the elements which establish the accord. (F. Br. 27-28, D. Br. 38-41) They fail to even challenge the authorities which demonstrate that the accord bars the "prompt filing" aspect of the 1969 claim. (D. Br. 38-41) They simply ask this Court to totally disregard the fact of the accord which was undisputed at trial, and the legal consequences that flow from the applicable and unchallenged legal authorities on this point. This is especially ironic since it is only the accord which permits them to argue that Diners was *ever* obligated to file. Without the accord, the Fugazys' nonperformance of the conditions would have remained as a complete bar to any claim by the Fugazys that Diners ever had such an obligation.

The existence of the agreement compromising the dispute as to the Fugazys' non-performance was an undisputed fact, and, in that circumstance, there was nothing for the jury to determine. It was the duty of the Court to direct a verdict that filing on August 28 was prompt as a matter of law.

POINT III

The Court clearly erred in permitting Friedman to construe the contract and to misstate the rights and duties of the parties thereunder.

The Fugazys contend that Friedman construed the Contract only on cross-examination while, on direct examination, they sought only his "expert opinion" in "securities regulation". (F. Br. 40-41) However, they cannot refute the facts which clearly demonstrate that the only "opinions" Friedman rendered, over objection, on direct examination were opinions as to the construction or legal consequences of the Contract, had nothing to do with "securities regulations" and relied on his knowledge and use of the English language. (D. Br. 49-52) The Fugazys do not even challenge the authorities, which establish that Friedman's direct testimony was improperly admitted. (D. Br. 52-57) The cases cited by the Fugazys (F. Br. 40-42) involve general principles of the trial court's discretion concerning expert testimony and do not involve, as here, the construction of a contract. The Court below was not permitted to allow Friedman to usurp the function of the Court to construe the Contract at bar. (D. Br. 52-57) *Loeb* v. *Hammond,* 407 F.2d 779, 781 (7th Cir. 1969); *La Chemise Lacoste* v. *The Alligator Co., Inc.,* 59 F.R.D. 332 (D. Del. 1973) The suggestion that the Court's standard instruction on the weight to be given an expert witness could somehow cure this fundamental and pervasive error is manifestly absurd. An instruction on weight could not cure the error in admitting his improper and prejudicial testimony. That error can only be cured by granting Diners a new trial on the 1969 claim.

POINT IV

The Court erred in taking judicial notice of the SEC report and permitting Friedman to incorporate that report in his testimony.

Having elicited Friedman's improper testimony that the Contract required Diners to immediately begin preparing the Registration Statement on April 16 and to file it by June 20, the Fugazys then introduced the SEC report and elicited Friedman's testimony, over objection, that Diners was required to cause the Registration Statement to become effective within 70 days following June 20. The Fugazys do not even attempt to distinguish the many authorities which establish that such evidence was erroneously admitted (D. Br. 58-62) except for a cursory and patently incorrect analysis of the *Apicella* case. (F. Br., footnote, 43-44; D. Br. 60) The Fugazys seek to minimize the error by suggesting that the jury might not have understood the 70-day figure to be the "authoritative standard", but it can no longer be questioned that the jury adopted the SEC *median* figure as described (erroneously as an average) by Friedman in selecting August 29 as the date the Statement was required to become effective. (F. Br. 7-8) Without the SEC figure and Friedman's improper use of it, it would not have been possible for the jury to select that date.

POINT V

It was prejudicial error for the Court to permit the Fugazys' expert witness to testify at all, since he was an improper rebuttal witness and a surprise witness.

Friedman was used in an attempt to make out the Fugazys' *prima facie* case and not to rebut anything (p. A-1600). The Fugazys offer no reason why Friedman, whom they had retained prior to trial (p. A-1533), was held out for rebuttal rather than being presented on the case-in-chief.

It is also clear that the Fugazys used improper gamesmanship to keep Friedman "in the closet" to unfairly surprise and prejudice Diners with his last-minute articulation of the contract claim (D. Br. 21-23, 63-67). The Fugazys' statement that they apprised Diners prior to the trial they would call an expert is untrue (F. Br. 36). That they failed to do that is confirmed by their admission that Friedman was not identified to Diners until the weekend of May 16 after two weeks of trial (F. Br. 36). There was no reason for such improper gamesmanship since they had admittedly retained Friedman prior to the trial (p. A-1533). It should also be noted that during the testimony of the last witness on their case-in-chief, the Fugazys' counsel actually advised the Court he would not be presenting any other "live witnesses" (p. A-1246). Yet, they subsequently presented Friedman as a rebuttal witness.

The Fugazys' brief also emphasizes that the lack of candor they displayed concerning Friedman's appearance was equalled by the deception they employed in presenting the 1969 claim as a contract claim which included the allegation of failure to promptly file. Their statement that the claim was fully presented in the complaint and the pre-trial order is ludicrous (F. Br. 4; D. Br. 7-9). They attempt to convince this Court of that by improperly attaching a portion of the language of the Order, without identification, to language of the Contract (D. Br. 7-9; D. 115, p. A-48, p. A-56). Equally ridiculous are the statements that they fully described that contract claim in their opening to the jury (F. Br. 4, 38). On the contrary, they expressly represented to the Court, the jury and Diners that this was a case of "fraud and misrepresentation" (pp. A-943-A-944). Indeed, based on that representation and the five-year history of pre-trial discovery on the Fugazys' single claim of fraud (D. Br. 7-9), Diners' counsel actually pointed out to the jury that Diners' counterclaims, unlike the Fugazys' claims, included claims for breach of contract as well as fraud (p. A-972) and specifically treated the 1969 claim as a fraud claim (p. A-975). This situation continued through the argument

of the directed verdict motion at the close of the Fugazys' case (p. A-1330).

The Fugazys next seek to show that they candidly presented their contract claim by serving a trial memorandum. They attempted to deliver the memorandum to the Court on the first day of trial, after the jury selection, without having even served a copy on Diners. The Court refused to accept it until Diners had been served.*

Even after service of the memorandum, the Fugazys continued to describe their case as one of fraud.

That Diners had no notice of any actual "prompt filing" claim is further borne out by the fact that the Fugazys only testified and were cross-examined on the "best efforts" element (pp. A-1090, A-1113-A-1114). Indeed, although their counsel obviously planned to assert that Diners should have filed by June 20, (D. 126, pp. A-99, A-137-A-138) the Fugazys themselves were apparently not aware of that. Their chief witness, William Fugazy, testified *several days into the trial* that he was not sure when the Registration Statement was filed and thought it was filed *in June* (pp. A-1078, A-1093, A-1105). The Fugazys' counsel cannot seriously contend that Diners had more knowledge of their claim than their own clients. The improper gamesmanship of the Fugazys requires a new trial on the 1969 claim. *Weiss* v. *Chrysler Motors Corporation,* 515 F.2d 449 (2d Cir. 1975).

With respect to this matter, as well as to other points raised in Diners' main brief, the Fugazys contend that Diners is precluded from complaining of the errors of the Court on this appeal because Diners did not object to the instructions to the jury. The law is well settled that an objection properly raised during trial is not waived by failure to object to instructions to the jury which might

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* Since the Trial Memorandum describes issues not included in the Pre-Trial Order and was obviously in preparation before trial, it is apparent that it was intentionally withheld from Diners until the pendency of the trial to achieve surprise.

be contrary thereto. *Krock* v. *Electric Motor & Repair Company,* 327 F.2d 213, 215-16 (1st Cir. 1964). As this Circuit stated in *Keen* v. *Overseas Tankship Corp.,* 194 F.2d 515 (2d Cir. 1952), *cert. denied,* 343 U.S. 966, 72 S. Ct. 1061, 96 L.Ed. 1363 (1952):

> Moreover, the [party's] failure later to repeat the objection, or to conform literally to Rule 51, was not a 'waiver' of the ruling against him; he had taken his position, had lost, and he was free thereafter to win a verdict if he could within the narrower borders of the case that the judge had laid down for him. Nothing goes further to disturb the proper atmosphere of a trial than reiterated insistence upon a position which the judge has once considered and decided. The notion is wholly untenable that in order to protect himself against an imputed surrender, a party must reassert what has been overruled every time the occasion comes up again. 194 F.2d at 519.

POINT VI

The undisputed evidence in the record establishes that the Fugazys had a direct or indirect interest in Travelco.

The Fugazys were required by the Contract to divest themselves of "any interest, direct or indirect" in Travelco (Ex. 5, pp. A-542-A-543; Ex. 34, p. A-761; Ex. 36, p. A-770), and were further prohibited from retaining or maintaining any interest whatsoever in Travelco, or any other franchise, and from being "connected in any manner with [Travelco] . . . without DFT's prior written consent" (Ex. 7, p. A-624; Ex. 34, p. A-761; Ex. 36, pp. A-770-A-771). The record is clear and uncontroverted that the Fugazys breached these contracts* by keeping an interest

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* These acts not only were a violation of these agreements, but at the same time constituted a breach of the fiduciary duties owed by the Fugazys to Diners and DFT, and, since material misrepresentations were made by the Fugazys, also constituted a fraud upon Diners and DFT.

in Travelco New York (the franchise at 342 Madison Avenue on 43rd Street) in three distinct ways: 1) the indemnity,* 2) the option,* 3) their officer and directorships** (D. Br. 24-30, 69-72).

In the face of no evidence to support their position, the Fugazys have set up an erroneous standard by which to measure their interest in Travelco, by repeatedly arguing that the evidence supports a finding that the Fugazys did not retain an "ownership" interest in Travelco (F. Br. 45-46). The issue was not whether the Fugazys retained an "ownership interest", but whether they held "any direct or indirect interest" or were "connected in any manner with Travelco." The uncontroverted evidence established that the Fugazys held such a prohibited interest (D. Br. 24-30, 69-72).***

Even if the standard were an "ownership" interest, the option, not to mention its automatic exercise, constitutes such an interest. Furthermore, the indemnity is an obligation sufficient to constitute an ownership interest, and certainly is at least a "direct or indirect interest" in, or a

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* The option and the indemnity were contained in the same document (Ex. FFF, p. A-864), which was admittedly not disclosed to Diners (p. A-1432), as counsel for the Fugazys conceded (p. A-1590).

** Counsel for the Fugazys, Mr. Fredericks stipulated to this fact (pp. A-1587, A-1464). The Fugazys' attempt to excuse this interest by asserting that Fugazy Travel's management team was required to be "represented in an executive capacity in Travelco" (F. Br. p. 20) is totally untrue. The record cites given by the Fugazys to support that assertion merely refer to the fact that the Fugazy Travel franchisees had the right to use the Fugazy name as a trade name, a right which commonly exists in franchise situations.

*** Twice in their brief the Fugazys refer to p. A-1447 to support their assertions that "neither Marx nor his stepson John Summerlin ever had any interest whatsoever in Travelco" (F. Br. 19, 45). That record cite in no way supports the Fugazys' assertion. Even if it did, that assertion is belied by the indemnity of Marx and Summerlin (Ex. GGG, p. A-871), which was admittedly not disclosed to Diners (p. A-1432).

connection with, Travelco in violation of the Contract and the Fugazys' employment agreements.*

The Fugazys set forth no evidence to support the verdict. They simply cite the testimony of William Fugazy reading from Exhibit EEE, the affidavit which the Fugazys were required to sign on October 30, 1967 (F. Br. 19-20, 44-46). In so doing, the Fugazys highlight the fact that this affidavit was false or that their indemnity, option, and officer and directorship interests in Travelco were somehow suspended for one day—October 30, 1967.

In the absence of evidence in the record to support the verdict, the Fugazys incorrectly claim that certain exhibits in evidence demonstrate that Diners had knowledge of their continued interest in Travelco, somehow excusing their violation of their covenants in their agreements. Diners' knowledge of the Fugazys' breach of their contracts would not serve to excuse the Fugazys from that violation. In any event the evidence relied upon by the Fugazys in no way demonstrates Diners' knowledge of their breach of contract, which the Fugazys' own counsel admitted was not disclosed to Diners (p. A-1590).

The Fugazys claim that their interest in Travelco was fully disclosed in the agreements with Mr. Fruchtman in June of 1967 (Ex. XX, p. 826; Ex. YY, p. A-860),** and in schedules to the Contract (Ex. 6, Schedules 4, p. A-574, 6, p. A-592). Those documents disclosed nothing of the interest of the Fugazys (the individual Plaintiffs) in Travelco, but merely described the relationship between

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* Counsel for the Fugazys, Mr. Fredericks, admitted that the indemnity constituted an "obligation" (p. A-1589). The Court below itself stated that the Fugazys "had this very involved interest in Travelco" (p. A-1589), and disagreed with Mr. Fredericks' assertion that these various interests had "no relevance" to the counterclaims (p. A-1590). The Court's failure to direct a verdict in favor of Diners and DFT on this aspect of their counterclaims is thus in conflict with its own characterization of the Fugazys' "very involved interest in Travelco."

** Cf. p. A-1590.

various corporate entities, including Travelco. It was the knowledge of that relationship, and of the interest of the individual Fugazys in Travelco, that led to the inclusion of covenants in question.*

Mr. Marx admitted the reason for Diners' insistence on the Fugazys' divesting of all interest in Travelco:

> "Q. Did anybody at Diners' Club tell you they wanted to make certain you and the Messrs. Fugazy had no interest in the Travelco office?
>
> A. Yes. I did hear that.
>
> Q. Did they tell you what the reason was?
>
> A. Yes, they did.
>
> Q. What was the reason given to you?
>
> A. Mr. Bloomingdale told me that he felt—and I agreed with it—that there should be no conflicts of interest and that Diners' Club should own the entire Fugazy Travel complex." (p. A-1422).

The significance of the Fugazys' breach of contract through their various interests in Travelco, stems from the circumstances surrounding the purported "sale" to Mr. Fruchtman of Travelco by the Fugazys in June of 1967 for "$250,000."

On June 19, 1967, the Fugazys and Mr. Fruchtman signed an agreement (Ex. XX, p. A-826) giving Fruchtman an option to purchase Travelco for $75,000. On June 21, 1967, the Fugazys had a meeting with Mr. Liftig concerning the proposed sale to Diners (pp. A-1005, A-1081, A-1420). On June 22, 1967, the Fugazys and Mr. Fruchtman signed a modification (Ex. YY, p. A-860) to the June 19, 1967 agreement (Ex. XX, p. A-826) increasing the option

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* The Fugazys' assertion that full disclosure of their interest in Travelco was made to Diners in 1967 is made even more incredible by the fact that when the Fugazys amended their employment agreements in October 1968, Diners insisted that they carry forward their covenant that they did not and would not have or maintain "any direct or indirect interest in Travelco." (Ex. 22, p. A-655).

price from $75,000 to $250,000 (for no consideration).* The Fugazys then booked this $250,000 as "revenue from the sale of franchises" in their June 30, 1967 financial statement (Ex. F, p. A-802), which was not prepared and submitted until August 22, 1967 (p. A-1419; Ex. F, p. A-802), after the memorandum of intent had been signed by Diners and the Fugazys on July 20, 1967 (Ex. 4, p. A-508).

The effect of this $250,000 "sale" was thus to convert a substantial deficit of Fugazy Travel into a substantial operating profit for the period ended June 30, 1967, and to make it appear as if a single franchise (342 Madison Avenue) had sufficient value as a going concern as to be able to yield $250,000 in an arms' length sale. However, the Fugazys' covert retention of an option and the granting of an indemnity to Mr. Fruchtman make it clear that it was no arms' length transaction.**

The Record demonstrates that this $250,000 "sale" was simply a paper transaction designed to balloon the operating revenues of Fugazy Travel's financial statement by $250,000, in order to convince Diners both that Fugazy Travel was in stable condition, and that its franchises had tremendous market value. Mr. Fruchtman was used as a straw man in this sham transaction, fully protected by the Fugazys' indemnification.***

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* Mr. Marx admitted that the indemnity, embodied in Ex. FFF (p. A-864), dated August 1, 1967, and in Ex. GGG (p. A-871) dated October 13, 1967, was discussed with Mr. Fruchtman at the time Ex. XX and YY were signed in June of 1967. (pp. A-1433-A-1434).

** Further evidence both of the Fugazys' continued interest in Travelco and of the sham nature of the "sale" to Fruchtman is found in Exhibit AAAA (p. A-891), which indicates that on November 21, William Fugazy placed Mr. Fruchtman on the payroll of Travelco as an employee at 342 Madison Avenue. It is rather strange to say the least, that a person who was to have divested himself of all interest in Travelco should place on the payroll of Travelco the person who is claimed by the Fugazys to have been the sole owner of Travelco.

*** That Fruchtman was simply a straw man is evident from the fact that, when he purportedly purchased and owned this travel agency at 342 Madison Avenue in New York, he lived in Toledo, Ohio and had no knowledge of the travel business (p. A-1421).

Not only did this transaction with Mr. Fruchtman convert Fugazy Travel from a loser to an apparently profitable comapny, but it also created the appearance of a divestiture, as required by the Contract, while, in fact, the Fugazys retained interests in and connections with Travelco in violation of the Contract.

It is respectfully submitted that the Court below erred in failing to direct a verdict in favor of Diners and that the jury verdict was totally unsupported by the evidence. At the very least, the verdict is against the overwhelming weight of the evidence, so that a new trial should be granted in the interest of justice.

POINT VII

The erroneous exclusion by the Court below of evidence relevant to the counterclaims requires the granting of a new trial.

The Court below excluded evidence related to three important areas of the counterclaims (discussed at D. Br. 31-34, 74-78). Contrary to the assertion by the Fugazys in their opposing brief (F. Br. 6), these evidentiary errors were not raised by Diners' in its post-trial motion, nor treated by the Court below in its opinion denying post-verdict relief, but are raised here for the first time after trial.

A. *Tower Suit*

The Fugazys argue that the facts related to the Tower Suit were "totally unrelated" to the counterclaims (F. Br. 46-48). They suggest that the Tower Suit did not involve any of the parties to the instant lawsuit. The caption in the Tower Suit read: "Fugazy Travel Bureau, Inc. v. Tower Credit Corporation." (Ex. L for ident., p. A-923). Fugazy Travel Bureau, of course, is the very company that sold its assets to Diners. The successor company to Fugazy Travel Bureau, F.T. Ventures, Inc., is a counterclaim defendant in the instant action. Furthermore, Plaintiff Otto Marx, the owner of Fugazy Travel Bureau

and the instigator of the Tower Suit, was, in reality, accusing William Fugazy,* not Tower, of having defrauded him in 1963 (D. Br. 32). Thus, the cast of characters in the Tower Suit was not at all different from the persons against whom Diners was asserting its counterclaims in this suit.

The Fugazys also argue that the Tower Suit was a "totally different" transaction from that involved in the counterclaims, and that, in any event, the Tower Suit was settled before the sale to Diners, and therefore not disclosable to Diners.** True, the Tower Suit was "settled" in August 1967, shortly before the closing of the sale to Diners.*** The point, however, is that the Tower Suit was settled in an obvious effort to conceal it from Diners, an effort which succeeded. Mr. Marx admitted that the Tower Suit was settled in an effort to smooth the way for a sale of Fugazy Travel (p. A-1291). Yet the "settlement" of the Tower Suit did not terminate the accusations of fraud which Mr. Marx was making against the Fugazy brothers, since, as part of the "settlement", Tower assigned to Mr. Marx (in return for $265,000) its claims against the Fugazy brothers, including its right of indemnity against the misrepresentations which had been made to Marx by the Fugazys in the 1963 transaction (Ex. J, p. A-807; Ex. K, p. A-816). The fraud surrounding the Tower sale in 1963 was but a mirror image of the

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* The materiality to Diners and its counterclaims of William Fugazy's character and reputation, as chief executive of Diners' travel subsidiary, is highlighted by the fact that when Diners had earlier terminated merger talks in 1965, William Fugazy himself expressed the fear that the reasons for the termination derived from "unfounded" rumors concerning his business dealings (Ex. B, p. A-800). The Court below described Mr. Fugazy as an indispensable part of the sale to Diners (pp. A-1169-A-1170).

** It is rather strange, but highly significant, that the suit of *Fugazy Travel* v. *Tower* was "settled" by the payment of $265,000 *to* Tower *by* Fugazy Travel (Ex. K, p. A-816; p. A-1443).

*** But after the letter of intent had been signed on July 20, 1967 (Ex. 4, p. A-508).

same fraud committed on Diners in 1967. The Court nevertheless excluded this evidence (D. Br. 31-34, 74-78).*

The prejudice to Diners by the exclusion of this evidence was magnified by the fact that Diners' counsel, in his opening statement to the jury, was permitted, over objection on the grounds of relevancy and prejudice (pp. A-980-A981), to outline the circumstances surrounding the Tower Suit, promising to present that evidence to the jury (pp. A-979-A-980, A-982-A-983, A-987-A-988). The Court below ruled that this was proper, since Mr. Fredericks had discussed the 1963 sale from Tower to Marx in his opening statement (pp. A-981, A-944), and because:

> "[The Court] If these gentlemen were engaged in business activities of a similar nature in the years prior to this, I should think that under one theory or another, the final theory would be that it would go to their credibility. I am going to permit it." (p. A-981).

Later in his direct examination of his own witnesses, Mr. Fredericks inquired into the circumstances surrounding the sale by Tower to Marx in 1963 (p. A-997). The Court subsequently ruled that Mr. Fredericks had opened the door to questions concerning Tower (p. A-1171), permitted counsel for Diners to ask groundwork questions concerning the Tower sale (pp. A-1139-A-1168, A-1178-A-1181, A-1255-A-1257, A-1284-A-1285, A-1443), but foreclosed cross-examination on the most important evidence relating to Tower, by excluding the first step in the development of that evidence—Ex. L for identification. The Court below excluded this evidence (D. Br. 31-34, 74-78), despite the fact that the Court had stated that this evidence was "relevant and material" (p. A-1172) and that "no documents are going to be kept out, if there is a showing of relevance." (pp. A-1067, A-1669-A-1670)

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* The Tower Suit, and the assignment to Marx of Tower's claims of fraud against the Fugazys, were relevant on the question of credibility as well (pp. A-1438-A-1439), since both William Fugazy and Marx denied that Marx possessed any claims against Fugazy (pp. A-1462, A-1444-A-1445).

The groundwork questions on Tower, and Exhibits J and K, were meaningless and confusing without the completion of the Tower story. Mr. Fredericks was able on his direct examination to present his version of the Tower sale, but foreclosed Diners from cross-examination into those same facts, claiming, ironically, that such evidence was prejudicial and irrelevant. Diners was thus precluded from fulfilling the commitment made to the jury in the opening statement (pp. A-979-A-983, A-987-A-988), severely damaging the credibility of its counterclaims.*

B. *The Attempted Sale of Fugazy Travel to Pierbusseti in 1966*

Similarly, the Court below erred in excluding evidence relating to the attempted sale by the Fugazys to Pierbusseti of the assets of Fugazy Travel Bureau in 1966 (Ex. H to H-4** for identification, pp. A-913-A-922; D. Br. 33-34, 77-78). The Fugazys tacitly concede that these documents were sufficiently authenticated for introduction into evidence.

However, the Fugazys argue that this was a "totally unrelated" transaction (F. Br. pp. 48-49). It would seem self-evident that proof to the effect that the Fugazys attempted to sell their company for $250,000 one year before they sold it to Diners for more than $8 million, during which period the Fugazys lost money in the operation of their company (Compare Ex. H-2, p. A-920 to Ex. F, p. A-802) would be evidence of the highest relevance in a counterclaim asserting fraud against the Fugazys in connection with the sale of the assets of their company to Diners.

This evidence was excluded after Diners' counsel had elicited preliminary testimony concerning the attempted sale to Pierbusseti (pp. A-1131-A-1135, A-1201-A-1202, A-1263-A-1277). The effect of this was to damage again

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* Mr. Fredericks was unrestrained in boasting of his success in having kept this evidence out of the Record (pp. A-1603, A-1611).

** These are referred to only as Ex. H in Diners' main brief.

the credibility of Diners' counterclaims in the eyes of the jury, by aborting the culmination of the development of the points that Diners was striving to make in support of this aspect of its counterclaims.

The circumstances surrounding the attempted sale of Fugazy Travel to Diners, embodied in Exhibits H to H-4 (for identif.) (pp. A-913-A-922), were relevant both to show the worthlessness of the assets of Fugazy Travel, an element of Diners' counterclaims, as well as to impeach the credibility of the Fugazys. This was acknowledged by the Court below (pp. A-1276, A-1355-A-1356). Nevertheless, the Court below excluded this evidence.

C. *Fugazy's Knowledge of the Unworkability of the Franchise Program*

Finally, the Court below refused to permit Mr. Anthony Piscatella of Pierbusseti to testify to Mr. William Fugazy's awareness of the unworkability of his franchise program which was not communicated by Fugazy to Diners* (D. Br. 34, 78). The importance of this evidence is demonstrated by the concession of counsel for the Fugazys that the principal assets being sold to Diners were the franchising concept and Mr. Fugazy (p. A-1170). Franchising was the "main thrust" of the business being acquired (p. A-1411).

The Fugazys attempt to justify the exclusion of this evidence by asserting that the testimony would have been self-serving, opinion testimony (F. Br. 49). Since Mr. Piscatella has absolutely no connection with Diners, there is no basis for the assertiton that his testimony would have been self-serving. However, it is at least ironic, if not incredible, for the Fugazys to contend that the possibility of self-serving testimony is a basis for exclusion, since the entire Fugazy case was made out only through the Fugazys themselves, and a paid expert witness. Secondly, Mr. Piscatella was not offered, nor was he intended, as an expert to give opinion testimony. Mr. Piscatella was simply going to relate statements made by

* And which caused Diners to lose $30 million.

Fugazy prior to the sale to Diners, through which Diners was to prove that Fugazy knew of or believed in the unworkability of his franchise program, and did not disclose this to Diners. Mr. Fugazy's knowledge and belief was a key element of Diners' counterclaims in fraud. Finally, the Fugazys' assertion that Diners' offer of proof on this issue was insufficient is belied by the transcript of the trial (pp. A-1358-A-1359).

It is respectfully submitted that the cumulative exclusion of all of the foregoing evidence was severely prejudicial to Diners and the development of its counterclaims, such that a new trial is required in the interests of justice.

Cross-Appellees' Answering Brief on the 1967 Claim

Introductory Statement

The Fugazys seek reversal of the decision of the Court below granting defendants' motion for a directed verdict at the close of the Fugazys' case, dismissing their claim that defendants defrauded them in violation of Rule 10b-5 in connection with their sale of the assets of Fugazy Travel in 1967 (hereafter "the 1967 claim"). The Fugazys' 1967 claim alleges that defendants misrepresented that there would be a Continental "takeover" of Diners at a specific point in time, which "takeover" would result in an increase in the value of the Diners' stock held by the Fugazys, and that the Fugazys relied on said misrepresentations in agreeing to the sale. The Court below ruled that the Fugazys had failed to prove that the defendants had made a material misrepresentation, and that the Fugazys had failed to establish reliance on any representation that had been made (pp. A-1342-A-1349, A-1601-A-1602).

Counter-Statement of Facts

No evidence was presented by the Fugazys that any representations were made as to the form in which this amorphous "takeover" was to occur. Nor did the Fugazys

prove that any specific date was represented to them within which this "takeover" was to occur.* Finally, the Fugazys failed to prove that they relied on any alleged representations made to them regarding a "takeover" when they sold Fugazy Travel to Diners. Indeed, the evidence showed that, in the absence of a sale to Diners, Fugazy Travel would most likely have gone bankrupt, demonstrating not only that the Fugazys did not rely upon any representations allegedly made to them, but also that any such representations would not have been material.

In attempting to demonstrate that they had made out a *prima facie* case, the Fugazys grossly distort the evidence in the Record. Any statements which the Fugazys attributed to a Mr. Liftig are not binding upon Diners, since Liftig was not representing Diners, but rather was representing the Fugazys (Ex. 5, p. A-515; Ex. 30, pp. A-667, A-691). Indeed, it was the Fugazys who had initiated the approach to Diners (pp. A-1296-A-1297), after Diners had rejected a similar proposal in 1965 (pp. A-1261-A-1262; Ex. B, p. A-800), and after the Fugazys had been turned down by Pierbusseti in 1966 (pp. A-1676-A-1689). Finally, Mr. Marx testified only that Lifting said a "takeover" might occur "in due course". (pp. A-1232-A-1233).

Mr. William Fugazy admitted that Jules Asch told him "nothing of a definitive nature" about a Continental takeover (p. A-1015). Furthermore, William Fugazy had testified at his deposition that he had only one meeting with anyone from Continental prior to the sale of Fugazy Travel to Diners in October 1967, and that nothing was ever mentioned to him at that meeting about Continental's "taking over" Diners (pp. A-1175-A-1177). Yet at the trial, Mr. Fugazy testified that at that meeting in September

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* The Fugazys testified that a specific timetable was given to them in 1968, after the Contract was signed (Ex. 5, p. A-513), but before they amended their employment agreements (Ex. 7, p. A-618; Ex. 22, p. A-645). Partially for this reason, the Court below refused to grant a directed verdict on the Fugazys' 1968 claim (p. A-1349), which was submitted to, and rejected by, the jury.

1967, Victor Herd of Continental said that "you don't court a girl unless you're going to marry her", testimony which was (a) contrary to Fugazy's deposition, and (b) in no way a material misrepresentation sufficient to make out a *prima facie* fraud under Rule 10b-5. Yet the Fugazys twice refer to this statement as the key misrepresentation upon which they relied in selling Fugazy Travel to Diners (F. Br. 18, 50). Even Mr. Fugazy admitted that any alleged representations to him by Mr. Bloomingdale,* who could not speak for Continental, were premised upon Fugazy's meeting the people from Continental—Victor Herd and Harold Johnson (pp. A-1016-A-1017). As indicated above, when Fugazy did meet those gentlemen, they gave him no assurances.

Plaintiff John Summerlin, Mr. Marx's stepson, admitted that he had never heard a specific date for a takeover (pp. A-1189-A-1190), and that his stepfather had never said he would not sell Fugazy Travel to Diners without assurances of a takeover (pp. A-1192-A-1197).

Plaintiff Louis Fugazy testified that he first heard of the "possibility" of a Continental takeover in October 1967 (long after the Memorandum of Intent was signed in July—Ex. 4), and that no discussion of any time period occurred until after Diners had purchased Fugazy Travel (pp. A-1213-A-1215).

Plaintiff Otto Marx never met with anyone from Continental prior to the sale of Fugazy Travel to Diners, and was never told of a date for a "takeover". (A-1310-A-1314). Marx thought that the deal with Diners was "an attractive deal" even apart from a "Continental takeover." (p. A-1300). If anything, Mr. Fugazy was Marx's source of information, since William Fugazy testified that he relayed the "You don't court a girl" statement to Mr. Marx (pp. A-1040, A-1044) (which was nothing close to a material misrepresentation). Finally, even if the statement

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* The Fugazys chose neither to call Mr. Bloomingdale as a witness nor to introduce any portion of his deposition into evidence.

attributed to Mr. Herd was in fact said by him, the courtship did result in a marriage when Continental extended its tender offer for Diners' stock (Ex. 26, p. A-657). Marx, a sophisticated investment banker (pp. A-1254-A-1255), was aware that "takeovers" can take "a lot of time" (pp. A-1310-A-1314), and that proposed mergers sometimes never take place (p. A-1307), which the Court below noted in granting the directed verdict motion (pp. A-1343-A-1344).

Fugazy Travel, it was revealed at the trial, was in such desperate financial condition that even if representations had been made to the Fugazys that a "takeover" of Diners would be occurring at a specific time, those representations would neither have been material nor relied upon by the Fugazys. To say the least, the Fugazys were most anxious to sell their travel company, as had been done in 1961 (to Tower), in 1963 (to Marx), and as had been attempted in 1965 (to Diners) and 1966 (to Pierbusseti).

Mr. Marx funded Fugazy Travel (pp. A-1128-a-A-1129). He had to extend loans to Fugazy Travel to meet its operating expenses (pp. A-1218-A-1222), and was unwilling to continue extending funds to Fugazy Travel (pp. A-1417-A-1418). Marx had invested more than $2 million in Fugazy Travel between 1963 and 1967 (pp. A-1255-A-1257, A-1690-A-1691), and had not recouped a single penny of that investment (p. A-1692). Fugazy Travel in 1967 was operating at a loss (pp. A-1258-A-1260), such that the Court below characterized the company as "worthless" (pp. A-1169-A-1170). Mr. Summerlin had purchased 10% of the stock of Fugazy Travel for $5,000 in 1965 (pp. A-1197-A-1198). The condition of Fugazy Travel in 1967 was such that Marx was considering putting it into bankruptcy (pp. A-1279-A-1280, A-1284-A-1285, A-1289, A-1290). To suggest that the Fugazys would not have consummated the sale of their company to Diners for $8 million, without firm assurances of a Continental takeover of Diners at a specific time, is ludicrous.

Lastly, despite an elaborate Contract for the sale of Fugazy Travel to Diners (Ex. 5, p. A-513), voluminous

schedules to that Contract (Ex. 6 p. A-564), and a memorandum of intent (Ex. 4 p. A-508), there was not a single piece of documentary evidence introduced by the Fugazys on their 1967 claim which made any reference to a "Continental takeover".

ARGUMENT

The Court below was correct in granting Diners' motion for a directed verdict on the Fugazys' 1967 claim.

The foregoing makes it clear that the Fugazys failed to establish either a material misrepresentation or reliance sufficient to make out a *prima facie* fraud case under Rule 10b-5. They have cited no cases or other authorities in their brief, and accepted the charge of the Court below on the standards for a 10b-5 cause of action (p. A-1625).

The Court below correctly dismissed the Fugazys' 1967 claim. See, *Radiation Dynamics* v. *Goldmuntz,* 464 F.2d 876 (2d Cir. 1972). The Fugazys neither proved a misrepresentation, nor satisfied the requirements of materality and reliance (not to mention scienter). *TSC Industries, Inc.* v. *Northway, Inc.,* 96 S.Ct. 2126 (1976); *List* v. *Fashion Park, Inc.,* 340 F.2d 457 (2d Cir. 1965), *cert. denied,* 382 U.S. 811, 86 S.Ct. 23 (1965):

> "The test of reliance is whether the misrepresentation is a substantial factor in determining the course of conduct which results in [the recipient's] loss.
>
> * * *
>
> The basic test of 'materiality', on the other hand, is whether 'a reasonable man would attach importance [to the fact misrepresented] in determining his choice of action in the transaction in question.'" 340 F.2d at 462.

"Account must be taken of all the surrounding circumstances . . ." *Chris-Craft Industries Inc.* v. *Piper Aircraft Corporation,* 480 F.2d 341, 363 (2d Cir. 1973).

Lastly, even if material misrepresentations had occurred, which were relied upon by the Fugazys, the representations were, at best, opinions as to future events, and not actionable unless completely unfounded, made recklessly, or deliberately intended to mislead, none of which was proved. *Myzel* v. *Fields,* 386 F.2d 718 (8th Cir. 1967).

Conclusion

For the reasons stated herein, and in Diners' main brief, it is respectfully requested that the relief sought in the main brief (D. Br. 79) be granted in all respects.

Respectfully submitted,

HARDEE BAROVICK KONECKY & BRAUN
Attorneys for Defendants-Appellants-Cross Appellees
One Dag Hammarskjold Plaza
New York, New York 10017

Of Counsel:

JOSEPH J. SANTORA
ROBERT B. KAY
ROBERT B. MCKAY
SALVATORE A. RANIERI
STEPHEN ROSS

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the within Reply Brief is
hereby admitted this 27th day
of July, 197

Davis Fredericks & Kaufman
Attorney for Manufacturers

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Edwin J. Connelly
Attorney for Plaintiffs